

Political Latitude and Institutional Change: Scale and Efficiency of Regional Technology-Based Economic Development Investments

Matthew Hamilton, Ph.D.

Carnegie Mellon University (www.cmu.edu)

Wellspring Worldwide (www.wellspringworldwide.com)

matt.hamilton@wellspringworldwide.com

Innovation is increasingly seen as the key driver of economic development strategy throughout nations such as the United States. Billions of dollars (based on collected data) are allocated to TBED (Technology-based Economic Development) by philanthropic organizations, state and local governments, and others to encourage technology commercialization and support new firm creation (e.g. Coburn and Berglund, 1994; Hart, 2004). Exploring TBED is important since governments and other communities are investing large amounts in these programs to change the institutions of innovation. Poorly designed policies or programs by institutional entrepreneurs could even be detrimental to innovation (Baumol, 1990). This is especially disconcerting, since regional political officials are observed to have an important role in determining investments and implementation strategies.

One of the challenges that governments confront is the ability to change existing rules and norms to adapt to new economic conditions. Individuals may recognize the need for adaptation, but they are embedded into an environment that dictates what is feasible and how changes to the existing institutions (North, 1990) can be achieved. Understanding the latitude of political or economic actors to initiate and implement institutional changes in response to new economic challenges is at the root of understanding how to implement and achieve successful economic development strategies. By latitude I refer to freedom from restraint, and flexibility to initiate changes through new programs and organizations in a region (i.e. TBED). Previous studies have not empirically examined the capability of actors to initiate change or on how changing incentives to these actors may influence the creation of new institutions.

The goals of this paper are two-fold: First, we explore how political latitude enables change to economic institutions. Second, we examine if the same political environment promotes inefficiency with regards to governmental investments in organization-based programs designed to create institutional changes.

My study examines more directly the previous findings about the role of politics in economic development policy. Analysis is performed on how political latitude (i.e. the lack of constraint or competition from opposing political parties) affects regional efforts to implement institutional changes in response to economic challenges. Prior work has emphasized the role that political competition can have, analogous to market competition, in creating efficiency (e.g. Stigler, 1972; Wittman, 1989). At the same time, others suggested that officials need control to make significant changes to a jurisdiction's economic institutions (Rodick, 2000; Henisz, 2000; 2004).

The empirical analysis uses a unique dataset of TBED investments to measure institutional changes. This includes over 400 different non-profit organizations along with state government program expenditures from 1998 to 2005. Political latitude is

explored through variables of legislative and gubernatorial control along with the *fraction* of legislative control. The majority of the analysis uses a linear, fixed-effect regression model for panel data with various controls for regional economic and political conditions.

Overall, political latitude was shown to have little positive influence on economic development programs and leads to significant problems in the creation of productive institutional changes. States responded to economic challenges regardless of the political party in control of the government. However, operational efficiency, measured by organizational expenditures, was significantly reduced when elected officials had greater political latitude. More interesting is how inefficiency materialized: control of the state governments by Republicans led to higher monetary investments in institutional change while greater legislative representation by Democrats produced more organizations. Regardless of party, organizations were susceptible to decreased efficiency when there was greater latitude in legislative control or when a higher ratio of program funding was provided by the government as opposed to private sources. A regional analysis shows that political latitude has a significant and negative influence on organizational efficiency in initial stages of development. This is particularly true in regions with a larger fraction of government support and where organizations were newly formed.

The study recommends increased constraints on elected officials and stronger monitoring from independent groups to improve the quality of institutional change with little impact on the ability of governments to initiate change. Giving elected officials greater latitude does not enhance, or hinder, their ability to initiate change in the face of changing economic conditions. Therefore, tighter constraints on elected officials can only improve the quality of the institutions for innovation. Further, program monitoring should be integral to the formation of new organizations as the greatest inefficiencies occur at the initial stages of development.

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